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C O N F I D E N T I A L SECTION 01 OF 02 TEGUCIGALPA 002289

SIPDIS

STATE FOR EB/IFD, WHA/EPSC, AND WHA/CEN
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SUBJECT: HONDURAS: TAX MAN IS MOVED BACK INTO MINFIN

REF: TEGUCIGALPA 1741

Classified By: Classified By: Economic Chief Patrick Dunn for reasons 1
.4 (b) and (d)

11. (C) Summary: The Honduran National Congress has decreed that the Executive Revenue Directorate (DEI) will no longer be a semi-autonomous tax agency and will instead be folded into the Ministry of Finance (MOF). The DEI is overstaffed and highly politicized, as alleged in the justification to move it back into MOF, but the move will not solve, and could exacerbate, these problems. In addition, the move gives MOF greater control over GOH revenue collection efforts, where they could be subject to abuse as the campaign season approaches. The loss of DEI autonomy concerns Post, and we will continue to monitor the situation closely, in particular for any signs of weakening resolve on fiscal restraint or any effect of the restructuring on our bilateral technical assistance program on tax administration. End Summary.

12. (C) On September 30, the Honduran National Congress issued a decision that the Executive Revenue Directorate (DEI, the GOH equivalent of the USG's Internal Revenue Service) will no longer be a semi-autonomous agency and will instead be folded into the Ministry of Finance (MOF). The DEI, formerly composed of the Customs Authority and the Tax Authority under the MOF, became independent in 1994 with the goal of improving the efficiency and credibility of tax collection. In recent testimony, Minister of Finance William Chong Wong called for the reintegration of the DEI into MOF, citing the DEI's lack of responsiveness to the MOF, the rapid growth in both its personnel and budget, and its politicization. In a conversation with EB Deputy Assistant Secretary Greenwood, however, Chong included in his list of motivations the fact that DEI employees were seeking to unionize. Moving them into the Ministry of Finance could impede this unionization, a concern that was protested by DEI employees on October 5 with a work-stoppage, supported by a peaceful demonstration by leftist Bloque Popular members. In settling the strike, Chong agreed there would be no reprisals against strikers, and former benefits, including salary and tenure, would be carried over in the DEI move to MOF.

13. (C) Post spoke on October 1 with Vice Minister of Trade and Industry Salvador Melgar Ascencio about the restructuring. Melgar noted that the bill was pushed through with very little debate, and in his view the situation is now worse than it was before.8 He admitted the DEI is inefficient and terrifically overstaffed, and said that the politicization of the staff continues to be a problem. (DEI staff positions experienced an earlier staff turnover once during the current administration for mostly political reasons.) However, he said, moving it to the MOF fails to address these core problems and introduces another. According to Melgar, Chong continues to operate an accounting consultancy in addition to his job as Minister, and as such he is in a position to clean up tax messes8 for clients or potential future clients. (Note: According to the Honduran Constitution, it is illegal for a government official to have two paid jobs in the public sector at the same time. It is unclear if there is a similar statute in force prohibiting such conflicts of interest involving a paid position in the private sector. In any case, this standard appears to be laxly or selectively enforced. For example, Minister of Investment Promotion, Camilo Atala also continues to manage Banco Ficohsa. End note.)

14. (C) The solution to the DEI's problems, Melgar said, is right-sizing and professionalization of the staff through adequate pay, job tenure, training, and promotion tracks that attract and retain qualified investigators. The current restructuring, by placing the DEI securely within the antiquated and inflexible Civil Service system, makes this kind of reform much more difficult and therefore unlikely.

15. (C) Another concern voiced by Melgar and echoed in the local press is that the restructuring will in some way also bring greater control over revenue accountability and disbursements to the MOF, where they could be subject to abuse as the campaign season approaches. He compared former Minister of Finance Alvarado with Chong, noting that rather than break the budget by finding8 an additional unbudgeted

USD 30 million for the electoral commission, Alvarado resigned. (Note: As noted reftel, the reality is somewhat more complex, but Post believes this issue did play a role in his decision to resign. End Note.) Chong, on the other hand, is inclined to disburse the funds, and is currently in talks with donors seeking additional contributions for this purpose. Melgar concludes that Chong will be far more responsive to National Party demands for increased spending as the elections draw near than Alvarado would have been, and Chong's assumption of direct control over the DEI could further facilitate this process.

16. (C) Comment: The loss of DEI autonomy concerns us, and we find many of Melgar's worries well-founded. A USG tax advisor, resident in the DEI, has previously told post that allegations continue to swirl within the DEI that Chong has blocked or otherwise disposed of tax cases against persons or firms with whom he has personal ties (reftel). Post is aware of no smoking gun, but continues to monitor the situation closely. Chong is also widely regarded as a member of the dark side, the old-guard of the National Party, reportedly willing to apply questionable tactics (such as the off-budget spending noted above) to ensure continued access to power. If Chong loosens the reins on fiscal restraint at the behest of the National Party to improve their chances at the polls, he risks increasing inflation, alienating donors, and potentially even breaking the pact with the IMF -- as happened in 2001 when the GOH's last IMF deal collapsed over irresponsible spending in the run-up to the 2002 elections. Post, the IMF, and the entire donor community will continue to press the GOH to restrain spending and comply with its IMF terms. We expect it will do so at least until it reaches HIPC completion point early in 2005. There is some concern at the IMF, however, that once that milestone is reached the GOH could lose its self-control and undo all its hard work to date. Given political pressures in the run up to the November 2005 elections, Post shares the Fund's concern that the GOH could fall off some elements of its IMF program at that time.

17. (C) Comment (continued): Post will also monitor the effect of this restructuring on our bilateral technical assistance program on tax administration. To date this program has been very successful in encouraging the DEI to take small but meaningful internal reforms aimed to improve collections and professionalize the tax service. DEI director Mario Duarte has been an enthusiastic (if not always effectual) supporter of the program. Duarte has made few public comments about the DEI reorganization, and some speculate that Duarte might be tapped to fill the Vice-Minister of Finance position vacated by Chong Wong in September when he became Minister. If he is not named Vice Minister, it is unclear what position Duarte would hold in the post-reorganization DEI. Post will watch to see whether Duarte is named to a Vice Ministership under Chong -- with whom there was reportedly tension when Chong was still Vice Minister of the Budget before becoming Minister -- and whether the DEI's move into MOF hampers Duarte's ability to pursue even the meager reforms we've seen to date. End Comment.

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